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RUEKJCS/SECDEF WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHDC
RHMCSUU/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC
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UNCLAS SECTION 01 OF 05 LAGOS 000097

SIPDIS

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E.O. 12958: N/A
TAGS: EPET NI PGOV ENERG
SUBJECT: NIGERIA NATIONAL ASSEMBLY PREPARES DOWNSTREAM GAS
ACT

LAGOS 00000097 001.2 OF 005

¶1. (U) Summary: Final investment decisions (FIDs) will be taken on the OK Liquefied Natural Gas (LNG), Brass LNG, Nigeria Liquefied Natural Gas (NLNG) and Equatorial Guinea LNG projects early in 2007. As a result, the Nigerian National Petroleum Corporation (NNPC) is pushing Nigeria's National Assembly (NA) to pass the Downstream Natural Gas Act. At hearings in the House of Assembly and Senate, witnesses from the public and private sector urged amendments to the bill, to assure the independence of the Gas Regulatory Commission (GRC). Members of both Houses also expressed support for an independent Gas Regulatory Commission (GRC). The Oil Producers Trade Section (OPTS) of the Lagos State Chamber of Commerce, which includes the international oil companies (IOCs), promised to submit proposed amendments for the House committee's consideration. As the country nears the FIDS, demand for gas is increasing. Nigeria hopes gas revenues will equal oil revenues by 2010. End Summary.

¶2. (U) The Nigeria's National Assembly held hearings on the Downstream Natural Gas Act in the House of Assembly Committee on Gas, chaired by Chief Mercy Almonei Isei, on January 18-19. The Senate Committee on Gas, chaired by Senator Rufus Initimi Spiff, held hearings on February 1-2.

Powers of Gas Regulatory Commission, Minister

¶3. (U) The bill establishes a Gas Regulatory Commission (GRC), which will provide commercial regulation for the downstream sector. In that capacity, the Commission will issue licenses relating to the supply, transportation, distribution and operation of the transportation network for

natural gas. This includes licenses for the sale and delivery of gas to end users; for the construction and maintenance of pipelines and infrastructure for conveyance of gas under high pressure from processing facilities, for construction and operation of distribution networks in local delivery zones; and for the management and operation of the transportation network. The GCR must ensure that a licensed Transportation Network Operator (TNO) provides third party access to the network, and may not purchase, own, or sell gas or participate in natural gas marketing or transportation. The Department of Petroleum Resources will continue to do downstream technical regulation as well as upstream regulation.

¶4. (U) The bill provides that the Minister of Energy and Petroleum Resources has the duty to formulate, determine and monitor downstream gas sector policy, determine when conditions are right for the initiation of a competitive market, issue regulations and ensure the independence of the Gas Regulatory Commission. The bill also provides that the GRC may amend, suspend or remove license conditions only upon consultation with the Minister of Energy.

Downstream Act Unbundles NGC

¶5. (U) The bill also provides that NNPC subsidiary the Nigerian Gas Corporation (NGC), will be bifurcated into the Nigerian Gas Transmission Company (NGTC), a gas transportation company, and the Nigerian Gas Marketing Company (NGMC), a marketing and distribution company. The NGTC will operate as an independent company; 51 percent of the company's equity will be sold to strategic investors with experience and financing capacity, while 49 percent will be retained by the Government of Nigeria (GON). All physical assets of the NGC will be transferred to the NGTC. Gas Sale

and Purchase Agreements and Gas Transfer Agreements between NGC and any third party will be transferred to the NGMC.

Pricing Provisions

¶6. (U) The bill gives the GRC power to regulate prices for monopoly services and services not sufficiently competitive to protect the interests of consumers. Prices for using the transportation and distribution networks will be regulated. End-user prices for captive consumers will also be regulated until competition is introduced and consumers have a choice of supplier. The GRC is charged with monitoring the downstream gas sector to determine its readiness for competition. The GRC is also empowered to prevent and/or curtail anti-competitive practices by its licensees.

¶7. (U) The GRC is charged with setting up a transitional pricing regime that will ensure full cost recovery for participants in the gas chain while avoiding a price shock when the subsidies inherent in the current pricing arrangements are removed. The regime will also eliminate cross subsidies prevailing in the sector and between gas and other sectors such as power and steel.

Fast Action on Bill Required for New Projects

¶8. (U) Group Managing Director of Nigerian National Petroleum Company (NNPC) Funsho Kupolokun testified at both hearings, explaining the purpose and content of the legislation. Drafting of the bill was begun when Kupolokun was Special Advisor to the President for Energy. NNPC took three years to prepare the bill, holding three stakeholders forums to get input from industry and interested others. Consultants from to the World Bank, McKenzie and Wood and Nigerian companies all worked on the draft.

¶9. (U) The legislation is necessary because the existing legal and administrative framework was created primarily for oil. There are insufficient legislative and regulatory provisions for activities in the gas sector. Existing contractual arrangements are opaque. For example, there are currently no commercial terms for gas discovered in Production Sharing Contract concession areas, Kupolokun explained.

¶10. (U) Nigeria's gas reserves have risen steadily to approximately 184 trillion cubic feet (TCF), despite the fact that there has been no direct exploration for gas, Kupolokun commented. Based on these numbers, Nigeria has the 7th largest gas reserves in the world. As with Nigeria's Bonny light crude oil, Nigeria's natural gas is high quality.

¶11. (U) Since the bill was introduced in 2003, there has been an explosion of demand for Nigeria's natural gas, Kupolokun said. Demand is expected to reach 15 bcf/d by 2010, with domestic demand accounting for about 30 percent of this volume. There are four projects, for which final investment decisions (FIDs) are scheduled in 2007, which will use Nigeria's natural gas:

-- Olakola (OK) Liquefied Natural Gas (LNG): This project will have a total of 4 LNG trains producing 5.5 million tons/year. The final investment decision (FID) will be taken in 2007. This project will boost Nigeria's LNG capacity by 22 million tons per year from 2011. 25 TCF of Nigeria's natural gas reserves have been allocated to this project.

-- Brass LNG: This project will have two LNG trains each with 5 million tons per year capacity. Final investment decision is targeted for 2007. Brass LNG will add 10 million tons per year to global LNG supplies. 10 TCF of Nigeria's natural gas reserves have been allocated to this project.

-- NLNG Train 7: 10 TCF of Nigeria's natural gas reserves have been allocated to this project.

-- Equatorial Guinea LNG: 5 TCF of Nigeria's natural gas reserves have been allocated to this project

¶12. (U) Kupolokun urged the committee to pass the bill as quickly as possible because these FIDs will result in the allocation of 50 trillion cubic feet out of the total 184 trillion cubic feet of reserves available, and the legislation is needed to properly capture the economic value of the gas for the country. Nigeria intends to collect as much revenue from natural gas as from oil by 2010. The bill will help Nigeria reach other goals, including ending flaring and addressing related environmental issues, extending gas penetration to the domestic market so as to facilitate the growth of the power sector and other industries, creating a level playing field between oil producers and other parties involved in the domestic gas business and increasing private sector participation, Kupolokun said.

¶13. (U) According to Kupolokun, historical and current prices for natural gas in Nigeria are extremely low. Domestic gas prices are below the cost of supply, which has resulted to an annual subsidy to the power sector of USD 50-80 million, created a disincentive to investment in gas gathering infrastructure; and distorted fiscal arrangements for the power sector. According to Kupolokun, price setting is opaque and discretionary; there is no basis for setting tariffs and wholesale prices.

House Hearings Focus on Independence of Commission

¶14. (U) Private attorneys and the Bureau of Public Enterprise testified that the bill does not make the GRC sufficiently independent of the Minister of Energy and

Petroleum. The Minister has the power to publish regulations, to be consulted with respect to the issuance or revocation of licenses, and to "ensure the independence of the Commission." The Department of Petroleum Resources expressed concern that the bill does not sufficiently distinguish its powers to regulate the technical aspects of downstream gas from the powers of the GRC to regulate the commercial aspects of downstream gas. Companies with existing contracts to transport and market gas expressed concern about whether their existing 20 year contracts with Nigerian Gas Corporation, a subsidiary of NNPC, would be honored. The Bureau of Public Enterprises, the arm of the Office of the President that is leading the privatization of state-owned companies, pointed out that entities named in the legislation, such as the National Gas Marketing Company and the National Gas Transport Company, would be privatized and thus should not be owned by NNPC as provided in the bill. BPE also noted that other entities named in the bill, such as the Petroleum Inspection Commission, have not yet come into existence. Others questioned the need for the Nigerian Gas Marketing Commission because gas can be marketed by the companies that produce it.

¶15. (U) The Oil Producers Trade Section (OPTS) of the Lagos

State Chamber of Commerce, which has as members many of the international oil companies (IOCs), urged the committee to minimize bureaucracy, avoid overlap with upstream sector regulation, ensure clarity of definitions, provide for the right to a hearing, ensure respect for contracts, set prices so investors can recoup their investment, assure a level playing field for new projects, respect existing commitments, and assure participation by private companies in the unbundling of NGC. The OPTS representative indicated that he would submit proposed amendments to the bill for the committee's consideration.

¶16. (SBU) The Special Advisor to the House Committee on Gas, told Pol-Econ Chief that following the hearing, the Committee adopted amendments assuring the independence of the GRC. Regulations, as recommended by the GRC, will be promulgated by the Minister. Fines and other penalties will be retained by the Commission so as to assure its greater independence. The number of members on the GRC was increased to nine to guarantee membership from all six geo-political zones. Tax benefits granted a project will not automatically be extended to an expansion of the project.

Senate Hears Plea for 50 Percent Derivation

¶17. (U) According to press reports, communities in the Niger Delta asked the Senate Committee to use the bill as a vehicle to increase to 50 percent the revenue from gas production shared with the communities. In addition, the communities asked that five of the GRC Commissioners come from the gas producing states, and that the headquarters of the GCR be sited in one of the nine gas producing states. BPE testified that the GCR should be independent of the Ministry of Petroleum Resources. According to press reports, Senators indicated that the failure of Minister of Petroleum Resources Edmund Daukoru's failure to appear to defend the provisions of the bill vesting power in his Ministry would result in the adoption of the BPE's recommendations.

Changes to Fiscal Regime, PSC Gas Contract Planned
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¶18. (U) In his testimony, Kupolokun also discussed planned changes to the current fiscal regime for natural gas. Reforms are needed to ensure that Nigeria receives a share of the economic rents generated from natural gas. The GON's upstream government take is negative at the price of USD0.50 per metric cubic foot of gas, while other countries that charge USD1.00 per mcf have positive government take. The

new fiscal regime, which will apply to both joint venture/sole risk (JV/SR) concessions and to production sharing contract (PSC) concessions alike. The new fiscal regime is intended to have a neutral impact; it will neither stimulate development of uneconomic gas projects nor deter profitable projects.

¶19. (U) The new regime is based on a sliding scale principle that allows the GON and the investor to share in the upside and downside of the project, Kupolokun claimed. The least profitable gas projects will be liable only to the minimum gas profits tax while the most profitable projects will be liable to gas profits tax at an effective 75 percent rate (a 20 percent minimum rate plus 55 percent maximum incremental rate.)

¶20. (U) The new fiscal regime is intended to be automatically responsive to varying project costs and price

conditions; progressive so that the government take increases proportionately with project profitability; and simple, so as to avoid multiple taxes and complex allowances that either create loopholes or provide too much incentive. The regime is focused on profit, not revenue or costs.

¶21. (U) Kupolokun also said that a gas development agreement for Production Sharing Contracts will be drafted. Because the PSCs are for oil exploration and development, gas discoveries are incidental to oil operations. A separate agreement is being developed to establish terms for the commercial development of the gas, taking into account that exploration costs are recovered from oil revenue, and unsuccessful oil exploration is considered a sunk cost. The NNPC retains ownership of PSC gas.
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